Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of	)	
	)	
Special Access Rates for Price Cap Local Exchange Carriers	)	WC Docket No. 05-25
	)	
	)	
AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services	)	RM-10593
	)	

REPLY COMMENTS OF BELLSOUTH

BELLSOUTH CORPORATION

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BellSouth Corporation, on behalf of itself and its wholly owned subsidiaries ("BellSouth"), hereby submits its Reply Comments in the above-captioned proceeding.

I. INTRODUCTION AND SUMMARY

The fundamental question the Commission must answer in this proceeding is whether there is sufficient competition in the special access market to constrain prices. If there is sufficient competition, then no justification exists for a return to the restrictive price regulation contemplated in the *NPRM*[1] and advocated by many of the parties that filed Comments. Instead, the competitive market should be allowed to set prices. The alternative approach of setting prices by regulatory mandate would have the unavoidable consequences of setting an incorrect price (i.e., one that does not correspond to a price that would be set in a competitive market),

[1] *Special Access Rates for Price Cap Local Exchange Carriers; AT&T Corp. Petition for Rulemaking to Reform Regulation of Incumbent Local Exchange Carrier Rates for Interstate Special Access Services*, WC Docket No. 05-25; RM-10593, *Order and Notice of Proposed Rulemaking*, 20 FCC Rcd 1994, 1995, ¶ 1 (2005) ("*NPRM*").

distorting the market, and damaging the development of competition in the market for special access services.

Based upon the Comments submitted by the parties, it is clear that competition exists in the special access market, and that it is robust, rapidly increasing, and more than adequate to constrain prices. For this reason, the Commission should, as a transitional mechanism, immediately remove all restraints on the LECs' pricing of special access services in all areas for a period of two years by granting Phase II pricing flexibility, after which special access services should be completely deregulated.

Twenty-five parties filed Comments in response to the *NPRM* issued in this proceeding. These parties can be generally divided into two camps: (1) those that advocate the recognition of the competitiveness of the special access market in the regulatory approach that the Commission takes, i.e., that the current constraints on LECs' pricing of special access services be either relaxed or removed altogether; and (2) those that deny the existence of competition in the special access market and request that the Commission impose restrictive price constraints on special access services as a means to artificially reduce prices. Not surprisingly the former group of parties is composed (in the main) of the sellers of special access services, while the latter group are (again, in the main) the buyers. What is surprising, however, is the difference in the amount and type of evidence offered by the two sides to support their respective cases.

The parties claiming that substantial competition exists have provided the Commission with extremely detailed information to prove this claim. For example, in its Comments, BellSouth provided (1) a detailed analysis of its special access prices which demonstrates that prices have not risen substantially over the last four-and-one-half years in areas having pricing

flexibility; (2) evidence of decreases in the per unit revenue attributable to special access services over this same time period; and (3) a comprehensive analysis detailing the respective market shares of BellSouth and its competitors. BellSouth also provided a Declaration by economists Harold Furchtgott-Roth and Professor Jerry Hausman, which independently demonstrated the existence of competition in the special access market and explained why even small amounts of competition will constrain prices in this market. The Declaration also described the futility of attempting to apply price regulation to the special access market. Likewise, Verizon, SBC, Iowa Telecommunications, and Valor Telecommunications filed detailed evidence demonstrating the presence of substantial competition for special access services in their respective service areas.

In marked contrast, the parties claiming competition in the special access market is minimal or nonexistent offered almost no factual support for this claim. Some relied only on vague anecdotal claims that they have been unable to find alternative vendors of special access services.[2] Most reargued information previously filed in other proceedings, often by other parties. Many restated old arguments based on inapplicable ARMIS data, but made no effort to address the obvious problems with the use of ARMIS data for rate setting purposes. Some argued that LEC prices have substantially increased, but either offered nothing to support this claim or else proffered information that directly contradicted this assertion.

Collectively, the parties that advocate the imposition of restrictive price controls on special access services filed only five new Declarations to address the many issues in this

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[2] For example, T-Mobile filed the Declaration of Chris Sykes ("Sykes Decl."), who stated that, "In MSAs where T-Mobile operates and where ILECs have obtained special access pricing flexibility, T-Mobile has seen little or no evidence of new entry by suppliers of special access services other than the ILECs." Sykes Decl., Attachment C to Comments of T-Mobile USA, Inc. ("T-Mobile"), at 3, ¶ 9. However, Mr. Sykes provides no detail beyond this general statement.

proceeding. One, the Ad Hoc Telecommunications Users Committee ("Ad Hoc") filed a Declaration by Susan M. Gately that updates a paper Ad Hoc submitted in various proceedings during 2004, and which relies heavily on the mis-use of ARMIS data. Two, CompTel/ALTS filed the Declaration of Janet S. Fischer, which relates to LEC pricing of special access services. Three, T-Mobile filed the Declaration of Simon J. Wilkie, which purports to present an empirical assessment of whether LEC prices for special access services are competitive. Four, T-Mobile also filed the Declaration of Chris Sykes, which contains a largely anecdotal description of T-Mobile's attempts to identify competitive providers of special access services. Five, Wiltel filed the Declaration of Mark Chaney, which consists of two pages of vague, unsubstantiated allegations. For reasons that will be explained below, none of these Declarations are persuasive.

In some ways, the most surprising aspect of the Comments by these parties is that they apparently felt no compunction to offer new information that went beyond the vague or anecdotal. If the Commission required no additional information beyond that which was already on the record, presumably it would not have issued an *NPRM*. The Commission did, however, include in the *NPRM* specific requests for additional information. For example, the Commission suggested that it would be useful for parties to provide a market share analysis.[3] BellSouth did so, unlike the parties claiming that no competition exists in the special access market. Likewise, the *NPRM* expressly requested that parties purchasing special access services "provide detailed information about their existing supply of special access facilities, including their ability or inability to self-deploy transport facilities, and/or to gain access to third party alternatives."[4]

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3 *NPRM*, 20 FCC Rcd at 2027-28, ¶¶ 103-06.

4 *Id.* at 2027, ¶ 100.

Despite this explicit request, none of the parties that claim that they have no alternatives to purchasing special access service from LECs provided the requested detailed information. The *NRPM* also "encourage[d] competitive LECs and other parties that have deployed their own special access transport facilities to provide their actual deployment cost information instead of relying on theoretical, estimated, or modeled costs of price cap LEC special access transport facilities."[5] Although a number of competitive LECs filed Comments, none provided this information.

Thus, the Commission is faced with a clear choice between, on the one hand, detailed information that documents the existence of competition in special access services or, on the other hand, unverified claims that competition is non-existent. This is no choice at all, and the only conclusion the Commission can reach consistent with reasoned decision-making is that substantial competition currently exists in the market for special access services.

Based on the unsupported contention that there is no competition, numerous parties also argued for prohibiting LECs from including discounts and other standard elements in their contracts and tariffs. These same parties argued (again, based on the ostensible lack of competition) that LEC special access rates should be lowered by various combinations of revoking pricing flexibility, indexing LEC rates to those of competitors in the market, applying an X-factor (based on presumed productivity), and the use of an 11.25% rate of return as a benchmark for rates. These proposals are seriously flawed. First, there is no factual support for the foundational assertion that there is little or no competition exists in the market for special

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5 *Id.*, ¶ 101.

access services. Second, even if there were a need for price regulation, the various proposals are generally unsupported and are calculated to yield low prices by any means, not to yield correct prices (i.e., those that would prevail in a competitive market). Accordingly, these proposals should be rejected.

II. ARMIS DATA CANNOT SUBSTITUTE FOR A PROPER ASSESSMENT OF THE COMPETITIVE MARKET

Even before Comments were filed in response to the *NPRM*, a myriad of information had already been filed in previous proceedings that established the many reasons that ARMIS data cannot be utilized to determine the profitability of special access services, or, for that matter, any individual service. Perhaps for this reason, the *NPRM* suggested only that ARMIS data be used for a limited purpose.[6] The *NPRM* also invited all parties to address the cost allocation issue by removing from the ARMIS data special access operating expenses and average investments that are not directly assignable, and to calculate growth rates based on the adjusted data, i.e., to, in effect, remedy the cost misallocations.

BellSouth responded by noting the previously filed Declaration of Drs. Taylor and Banerjee, which discussed at length the many reasons that ARMIS data cannot be used for any purpose that involves assessing the margins of, or setting rates for, special access services.[7] BellSouth also noted the fundamental problem that, even if ARMIS data could be validly used for this purpose, it provides too little information to support a meaningful conclusion about

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6 *Id.* at 2006, ¶ 29.

7 BellSouth Comments at 8-11.

competition in the special access market.[8] Specifically, the *NPRM* proposed to use ARMIS data to compare the increases in the demand for LEC special access services to the increases in expenses and investments for these services. As BellSouth noted, considering only the increase in demand for BellSouth's special access services (as reflected in ARMIS data) leads to an incorrect conclusion about the market by failing to consider the greater demand increase in the market in general and the concomitant decline in BellSouth's market share.

Since BellSouth, Verizon, SBC, and Qwest have all addressed this issue at length, BellSouth will not reiterate all of the reasons that ARMIS data cannot be used to make any valid judgment about special access services. A summary of these reasons, however, would include the following: (1) ARMIS data was not intended to be utilized for ratemaking purposes and has never been used for this purpose; (2) the application of ARMIS data to specific services necessarily involves arbitrary allocations that render any resulting conclusion about profit margins untenable; and (3) even if there were not a fundamental cost allocation problem with the proposed use of ARMIS data, the separations freeze that has been in effect since 2001 has had the effect of only taking into account increases in special access revenue, without taking into account increases in costs incurred during this time period.

Moreover, in the Reply Declaration of Drs. Furchtgott-Roth and Hausman,[9] they note that this usage of ARMIS data is not economically sound and that it has been abandoned by both the Federal Trade Commission and the Department of Justice:

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8 *Id.* at 11-12.

9 *See* Attachment 1 ("Furchtgott-Roth/Hausman Reply Decl.").

> Economists have long recognized that rates of return calculated using accounting allocations make no economic sense. Telecommunications networks produce many services and the accounting allocations to calculate rates of return are inherently arbitrary. Economists have further known that because of difficulties in determining economic depreciation that rate-of-return calculation cannot give useful information on supra-competitive price or market power. Indeed since the Federal Trade Commission (FTC) lost the cereals case in the early 1980s based on a ruling that accounting rates of return could not be used to infer market power, the FTC and Department of Justice rarely, if ever, use accounting rates of return in a monopolization case. Since these are the expert agencies in evaluating market power, the Commission should take note of their non-use of accounting rates of return to infer market power.[10]

Despite the many problems with the application of ARMIS accounting data to special access services, most of the parties that argue for the imposition of restrictive price controls base their arguments either exclusively or largely upon the misuse of ARMIS data. Some do so directly, and some do so by referring to a third-party analysis based on ARMIS data.[11] However, these parties do virtually nothing to defend their use of ARMIS data or to address the many reasons why this use is improper. Again, in recognition of the cost allocation issues in ARMIS, the *NPRM* proposed to make a limited use of ARMIS data, and invited parties to suggest ways to deal with the allocation issues that arise from the use of this data.[12] Surprisingly, not a single

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[10] *Id.* at 17-18 (citations omitted). These Comments appear in the context of a rebuttal to the Declaration of Simon J. Wilkie, which was filed as Attachment B to the Comments of T-Mobile.

[11] For example, Ad Hoc filed a paper prepared by Economics and Technology, Inc. in August of 2004 ("ETI paper"), which has been previously filed in other proceedings, and a Declaration by Susan M. Gately, which is intended to be an update of the ETI paper. Both the original paper and the Gately supplement rely heavily on the use of ARMIS data.

[12] "To demonstrate the possible impact of cost allocations during the price cap period of regulation, including before and after the CALLS plan and pricing flexibility were implemented, we invite parties (1) to remove from the BOCs' interstate special access operating expenses and average investment data reported in ARMIS any expenses and investments that are not directly assignable; and (2) to calculate the compound annual growth rates for BOC interstate special access operating expenses and average investment using these adjusted data." *NPRM*, 20 FCC Rcd at 2006, ¶ 29.

proponent of using ARMIS data responded specifically to this invitation. Instead, they ignore these issues and continue to advocate the misuse of ARMIS data.

The few efforts to defend the use of ARMIS data can be charitably characterized as implausible. The only substantive defense of using ARMIS data was by Ad Hoc, which merely restated the contention that "minor cost mis-allocations at the margins d[o] not affect the overall integrity of *trends* in the data, since these alleged mis-allocations do not change from period to period."[13] This contention was first stated in the 2004 ETI paper, and it was specifically rebutted by Drs. Taylor and Banerjee in their Declaration filed on November 8, 2004,[14] which was quoted in BellSouth's Comments. Drs. Taylor and Banerjee explained that these "mis-allocations are unlikely to be minor, . . . or [to] have benign consequences for pricing services."[15] Accordingly, "almost universally, economists reject allocated (or distributed) costs as the basis for efficient pricing."[16] Further, the misallocations have not been consistent due to the effect of the separations freeze.[17]

Obviously, the parties that attempt to rely on ARMIS data do so because this reliance provides a means, albeit not a particularly credible one, for them to argue that special access service is so profitable that it must not be competitive. Still, it is surprising that they would base their arguments on ARMIS data without making some attempt to address the inherent problems

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13 Ad Hoc Comments at 29.

14 Declaration of William E. Taylor, Ph.D., and Aniruddha Banerjee, Ph.D., NERA Economic Consulting, On Behalf of BellSouth Corporation, RM No. 10593 (filed Nov. 8, 2004) ("NERA Decl.").

15 *Id.* at n.49.

16 *Id.*

17 *See* BellSouth Comments at 10-11.

with this particular use of the data. In this situation, the fact that they have done little or nothing to defend their use of ARMIS data provides a clear indication that this use simply cannot be defended. Accordingly, the Commission cannot rely on ARMIS data to assess the competitiveness of the special access market.

III. BELLSOUTH'S PRICES FOR SPECIAL ACCESS SERVICES HAVE NOT SUBSTANTIALLY INCREASED

The *NPRM* identified substantial and sustained price increases as a basis to assess the level of competition in the market for special access services.[18] By contrast, if prices have not substantially increased, then one must necessarily conclude that competition is constraining prices.

The uncontroverted evidence presented in the Comments demonstrates that BellSouth's prices have not increased substantially. As BellSouth stated in its Comments, the month-to-month ("MTM") rate for special access services has increased over the last four and one half years by a total of 8% for DS1 service and 9% for DS3 service.[19] Since the rate of inflation during this time period was 11.14%, BellSouth's MTM rates for special access service have declined in real dollars from January 2001 to the present.[20] At the same time, the rates under the term plans offered by BellSouth have remained unchanged during this time period. In light of the 11.14% rate of inflation that applied during this timeframe, this means that the special access prices available under term plans decreased substantially in real dollars. Further, since most

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18 *NPRM*, 20 FCC Rcd at 2019, ¶ 73.

19 BellSouth Comments at 15-16.

20 *Id.* at 16 & n.36.

BellSouth customers choose to purchase special access services under a term plan,[21] this means that most purchasers of BellSouth's special access service have enjoyed unchanged prices that reflect a considerable rate decrease in real dollars. Even lower rates are paid by BellSouth customers that choose term and volume discount plans.[22]

A number of parties presented analyses of BellSouth's rates in areas in which pricing flexibility has been granted, and their findings are consistent with the foregoing. For example, the price analysis presented by Sprint shows that BellSouth's rates under plans with terms of 61 to 96 months have not changed since 2001.[23] CompTel/ALTS presented the Declaration of Janet S. Fischer, which lists BellSouth's rates as unchanged since 2001 under term plans of 37 to 60 months and slightly increased under MTM plans. Ad Hoc also makes the generally correct claim that BellSouth's DS1 rates have increased 8% "since pricing flexibility was granted."[24] Unfortunately, Ad Hoc does not disclose that its claim is based solely on the MTM rate that applies to only a small fraction of BellSouth's DS1 customers (whose purchases comprise 8% of the revenue), rather than the lower rates that apply to the vast majority of DS1 purchasers who have chosen other plans (and whose purchases yield 92% of the revenue). Still, had Ad Hoc disclosed this information, its representation of BellSouth's prices would have been consistent

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21 BellSouth obtains 92% of DS1 revenues and 75% of DS3 revenues from services that are discounted under one of the applicable term plans. *See* BellSouth Comments at 16-17.

22 *See id.* at 17-18.

23 Sprint Comments, Attachment 1 at 7.

24 Ad Hoc Comments at 21. Ad Hoc, however, also made the mistaken claim that, "BellSouth imposed a region-wide increase in the price of a DS1 channel termination in the Phase II MSAs in all of its nine states fifteen months[s] ago, in March of 2004." *Id.* at 20. A review of BellSouth's filed tariffs will confirm that there was no price increase in March of 2004.

with BellSouth's own assessment. No other party presented an analysis of the prices that BellSouth has charged for special access services under pricing flexibility.

Given the above, it is surprising that both Ad Hoc and CompTel/ALTS (as well as a number of other parties) claim that BellSouth's special access prices have substantially increased during this time frame.[25] This claim, of course, raises the question of how rates that have remained steady can be plausibly categorized as having substantially increased. The answer is that these parties have chosen to take a patently untenable and misleading approach: since they have no basis to contend that BellSouth's rates under pricing flexibility have actually increased, they treat every instance in which rates in areas subject to pricing flexibility are now higher than the annually reduced price cap rates as if a rate increase has occurred.[26]

In addition to the obvious fact that this approach is illogical, it suffers from two additional infirmities. First, these parties have not addressed the question actually posed in the *NPRM*. In the *NPRM*, the Commission requests that parties claiming LEC special access rates have substantially increased (1) provide "recent data" to establish the increase; (2) propose and

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[25] Ad Hoc Comments at 16-21; CompTel/ALTS Comments at 6; XO Comments at 5-9.

[26] Some parties were fairly straightforward in advancing this claim. Other assertions that BellSouth has raised its prices required some investigation into the basis of the claim. For example, T-Mobile relied upon the Declaration of Simon J. Wilkie, who claims that in Alabama, BellSouth's special access "rates increased 35.7% for fixed charges and 48.9% for variable charges since pricing flexibility was granted." Wilkie Declaration at 13. Dr. Wilkie cites to page 150 of Noel D. Uri & Paul R. Zimmerman, *Market Power and the Deregulation of Special Access Service by the Federal Communications Commission*, Information & Communications Technology Law, 129-173 (2004) ("Uri & Zimmerman"). However, a review of Uri & Zimmerman reveals that Dr. Wilkie has quoted rates that Uri and Zimmerman attribute to Southwestern Bell-Arkansas, not BellSouth. The Uri & Zimmerman paper does claim that BellSouth's rates in areas in Alabama subject to pricing flexibility are higher than price cap rates (which Uri & Zimmerman refer to as "conventional rates"). However, what Uri & Zimmerman call a "price increase" is largely attributable to reductions in the rates in price cap areas rather than increases in the rates in areas subject to pricing flexibility. *Id.* at 142-46, Table 3b.

support a benchmark by which to determine if the rate increases are substantial; and (3) "provide a measurement of the sustainability of the rate changes."[27] Clearly the Commission was not asking parties to simply compare tariffed, filed rates for pricing flexibility and price cap areas.

Second, a mere comparison of price cap to pricing flexibility rates avoids the fundamental question that underlies the Commission's request: whether there is sufficient competition to constrain rates. The issue is whether prices have substantially increased in a way that reflects a lack of competition or if prices have been held in check by competition. If one accepts these parties' definition of a price increase, then it is also necessary to accept their unlikely premise that in a non-competitive market that is not price regulated, a party having market power would utilize this power to either keep prices precisely the same or increase them by less than the prevailing rate of inflation. Thus, these parties take the unique (and implausible) position that the existence of market power can be demonstrated in the absence of true price increases.

When one decodes this novel argument and separates it from the question of price increases actually posed in the *NPRM*, it becomes clear that the real premise advanced by these parties is that prices in areas that are subject to pricing flexibility are at supra-competitive levels if such prices are higher than the perpetually decreasing rates in areas subject to price caps. This premise is, of course, based on the erroneous assumption that prices in price cap areas are absolutely correct, i.e., that they are at precisely the level that would exist in a competitive

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[27] *NPRM*, 20 FC Rcd at 2019-20, ¶¶ 73-75.

market. However, there is no basis to make this foundational assumption, and every reason to believe the opposite.

As set forth in the Declaration of Drs. Furchtgott-Roth and Hausman, it would be virtually impossible under even the best of circumstances for the Commission to set prices for special access services that are precisely correct.[28] In light of what has transpired over the last 15 years, it would be miraculous if the current rates that apply in price cap areas (as the historical artifacts of various types of reductions) happened to be the correct rates, i.e., the rates that would be set by competition.

The X-factor that has been applied annually to reduce access rates was originally imposed in 1990 as a productivity factor.[29] It was the product of a belief that the telecommunications industry was more productive at that time than the economy in general. Even then, this notion was extremely controversial, and the process of developing an X-factor was a difficult one.[30] The Commission, of course, ultimately set a productivity factor of 5.3%, which was sustained only after a lengthy appeal.[31]

This X-factor remained in place until the implementation of the CALLS plan in 2000. In other words, the factor remained unchanged during the multitude of changes that occurred in the telecommunications industry during the 1990s (*e.g.*, the passage of the Telecommunications Act

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28 Furchtgott-Roth/Hausman Declaration, Attachment 7 to BellSouth's Comments, at 27-28.

29 *Policy and Rules Concerning Rates for Dominant Carriers*, CC Docket No. 87-313, *Second Report and Order*, 5 FCC Rcd 6786 (1990).

30 *Id.* at 6793-6801, ¶¶ 55-119.

31 *Price Cap Performance Review for Local Exchange Carriers,* CC Docket No. 94-1, *First Report and Order*, 10 FCC Rcd 8961, 9050, ¶ 199 (1995), *aff'd Bell Atlantic Tel. Cos. v. FCC*, 79 F.3d 1195, 1202-05 (D. C. Cir. 1996).

of 1996), and which resulted in a transition from the minimal competition for special access services to a fully competitive market. It seems unlikely that the passage of the 1996 Act and the advent of widespread competition had no effect on productivity, but the productivity factor set at the beginning of the decade, nevertheless, applied during this entire time period.

In 2000, the X-factor changed, pursuant to the negotiated, Commission-approved CALLS plan. The CALLS plan included no effort to index the X-factor to productivity. Instead, the X-factor in the CALLS plan was structured to achieve a negotiated rate reduction during the life of the plan.[32] Thus, the current price cap rates are the product of applying to special access rates that existed in 1990 two different X-factors designed to serve different purposes, neither of which was an attempt to replicate the prices that would exist in a competitive market. As a result, the notion that the current price cap rates are precisely as they would be in a competitive market is preposterous.

Nevertheless, the parties that argue that the current prices in pricing flexibility areas are too high necessarily make this flawed assumption. Moreover, they do so without the benefit of any support, and without providing any rationale by which one could conclude that prices set under the price cap regime are at competitive levels. Instead, they simply assume that price cap rates are correct, then use this unlikely assumption as the springboard for arguing that if rates in

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[32] *Access Charge Reform; Price Cap Performance Review for Local Exchange Carriers; Low-Volume Long-Distance Users; Federal-State Joint Board on Universal Service*, CC Docket Nos. 96-262, 94-1, 99-249 & 96-45, *Sixth Report and Order in CC Docket Nos. 96-262 and 94-1, Report and Order in CC Docket No. 99-249, Eleventh Report and Order in CC Docket No. 96-45*, 15 FCC Rcd 12962, 13028, ¶ 6 (2000) ("*CALLS Order*"); see also *NPRM*, 20 FCC Rcd at 2000-01, ¶ 15.

areas where pricing flexibility has been granted are higher, then these rates must be at supra-competitive levels. This argument is pure sophistry, which the Commission must reject.

Although numerous parties claimed that the LECs' special access prices are too high, only one party did anything other than compare prices in pricing flexibility areas to prices in price cap areas. Specifically, T-Mobile filed the Declaration of Simon J. Wilkie, which purports to contain empirical support for the argument that prices in areas having pricing flexibility are at supra-competitive levels. However, Dr. Wilkie's declaration is so fundamentally flawed that it cannot be relied upon for this (or any) purpose. As noted in the Reply Declaration of Drs. Furchtgott-Roth and Hausman, the Wilkie declaration has "several shortcomings that render it inadequate as a basis for FCC consideration of price regulation of special access."[33]

The first flaw lies in Dr. Wilkie's description of the relevant market. For purposes of analyzing the CMRS providers' usage of special access services, Dr. Wilkie focused "on the base station-to-central-office link as the relevant product market."[34] Dr. Wilkie also stated that this link has the same economic characteristics as a local loop, that there is only one customer location served by the link (the CMRS carrier's base station), that it carries low volumes of traffic, and that most costs incurred to provide the link are sunk costs. However, "[n]o evidence is provided to substantiate any of these assertions."[35] Dr. Wilkie also asserts that any CMRS provider that enters the market and loses its single customer will lose its sunk investment. He

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33 Furchtgott-Roth/Hausman Reply Decl. at 9.

34 *Id.*

35 *Id.*

neglects, however, to consider that this loss can be mitigated by entering into a long-term contract to remove much of the risk of the sunk investment.[36]

Also, Dr. Wilkie erroneously defines the market as including a single consumer, the CMRS carrier.[37] This definition has been routinely rejected by both antitrust economists and the courts.[38] Dr. Wilkie also assumes that the market for loops and transport is "point-to-point" or route-by-route." For the reasons explained in the Reply Declaration of Drs. Furchtgott-Roth and Hausman, this assertion is also incorrect.[39]

Second, Dr. Wilkie inappropriately imputes competitive rates. Dr. Wilkie's conclusion that special access rates are set at supra-competitive levels is based on an exercise in which he takes the price of a DS3 line that runs from New York City to Los Angeles, divides the price by the mileage, and calculates a rate of $1.40 per mile.[40] However, in this calculation, "Dr. Wilkie completely missed the mileage insensitive costs associated with DS3 service and many other services."[41] Because Dr. Wilkie fails to appropriately reflect the fixed nature of these mileage insensitive costs, his "entire approach of finding that New York City-to-Los Angeles transport costs are less expensive on a per-mile basis than Verizon's transport costs in New York City makes absolutely no economic sense."[42]

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36 *Id.* at 9-11.

37 *Id.* at 11.

38 *Id.* at 11, 12.

39 *Id.* at 12-13.

40 *Id.* at 13.

41 *Id.*

42 *Id.*

Dr. Wilkie also ignores the fact that "[m]arket prices reflect demand conditions, cost conditions or technology, and competitive conditions in that market,"[43] and his analysis is irreparably flawed by his failure to account for these factors. Also, Dr. Wilkie performs a regression analysis that, in addition to failing to account for demand conditions or competitive conditions, also assumes a uniform cost structure across all markets, an assumption that has no empirical basis.[44] Beyond this, Mr. Wilkie's analysis is based on data that is either not presented, proprietary, or drawn from contracts that do not have consistent provisions.[45]

Third, Dr. Wilkie's comparison of special access rates, UNE rates and ARMIS data is invalid. Dr. Wilkie contends that special access rates must be too high because they are higher than UNE rates. However, as explained by Drs. Furchtgott-Roth and Hausman, "[t]he economic issues are: 1) whether there is an economically rational basis for price regulation; and 2) if so, whether an economically rational method of calculating regulated rates is available. The comparisons offered by Dr. Wilkie address neither issue."[46]

Dr. Wilkie's attempt to calculate rates of return based on ARMIS data is equally flawed. The error in Dr. Wilkie's use of ARMIS data was discussed at length previously.[47] Moreover, as stated in the Reply Declaration, "[e]conomists have long recognized that rates of return calculated using accounting allocations make no economic sense. Telecommunications networks

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43 *Id.* at 14.

44 *Id.* at 15.

45 *Id.* at 16.

46 *Id.* at 17.

47 *See*, *supra*, pp. 6-10.

produce many services and the accounting allocations to calculate rates of return are inherently arbitrary."[48]

Thus, the only attempt by any party to present empirical support for the argument that LEC special access service prices are supra-competitive is flawed in almost every aspect. Clearly, it can be given no credence whatsoever by this Commission.

IV. THERE IS SUBSTANTIAL FACILITIES-BASED COMPETITION

A. The Parties That Claim There Is No Competition Rely Largely On Anecdotal Information, But Do Not Disclose The Pertinent Information In Their Control

The parties that argued in their Comments for restrictive pricing restraints claimed that there is little or no competition in the market for special access services. Most of these claims, however, are accounts by specific carriers of their unsuccessful efforts to obtain an alternative to special access service in a few instances.[49] These anecdotal accounts cannot serve as the basis to draw conclusions about the entire market for special access services. Moreover, if the Commission is inclined to consider this type of information, then it should also consider the experience of Verizon, which had no difficulty finding competitive alternatives to the purchase of special access services outside its region. Specifically Verizon stated the following in its Comments:

> In nineteen of the twenty-eight areas for which it selected a primary access provider, Verizon contracted with a competitive carrier to be its primary access provider. In three of the six areas in which it also selected a secondary access

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48 Furchtgott-Roth/Hausman Reply Decl. at 17.

49 *See, e.g.,* T-Mobile Comments at 7-10; Broadwing/SAVVIS Comments at 14-19; Sprint Comments at 6.

> provider, Verizon chose a competitive provider to be its secondary access provider. Through these carriers, Verizon is now offering high capacity services on a competitive basis in at least twenty-six out-of-region states.[50]

In general, it is troubling that so many carriers offered so little concrete information to support their contention that competition does not exist for special access services. Carriers purchase special access service as an input to the retail service that they provide to customers. Thus, they know precisely the number of customers to whom they are connected. Regrettably, none of these carriers offered to provide information as to the locations at which they have placed facilities or the customers they serve. CompTel/ALTS states in its Comments that it represents "more than 300 members . . . [including] competitive, facilities-based telecommunications service providers, emerging VoIP providers, integrated communications companies and their supplier partners."[51] Yet rather than providing any information about the actual competitive efforts of its more than 300 members, CompTel simply claims there is minimal competition based on ARMIS data and a misleading price analysis.

In the analysis by 10th Street Advisors discussed below,[52] 10th Street identified 87 carriers other than BellSouth that provide facilities-based competitive service in BellSouth's service area. A number of these carriers filed Comments in this proceeding. Most of these carriers claimed that there is little or no competition to the LECs special access services, but not one making this

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50 Verizon Comments at 33.

51 CompTel/ALTS Comments at 1.

52 *See*, Attachment 2, Reply Declaration of Dr. Stephanie Boyles ("Boyles Reply Decl.").

claim divulged any information about the competitive facilities that they deploy or the customers they serve with these facilities.[53]

Thus, carriers make general claims that there is no competition, but provide none of the true facts about competition that only they have at their disposal. Assuming they address the issues in this proceeding as they have in the past, these same parties will likely criticize BellSouth's efforts to provide the Commission with accurate and specific information about the competitive market for special access service, but will still not reveal the actual facts in their possession. The only way to remedy this situation is for the Commission to require competitive carriers to provide specific information as to where they compete, where their facilities are located, the services they provide, and the customers they serve with these facilities.[54] Put simply, no carrier should be allowed to make vague claims that there is no competition while refusing to provide the specific facts about its own competitive efforts.

B. Some Parties Minimize The CLECs' Market Share By Overstating The Size Of The Market

Even the few parties that ostensibly provided empirical support for the claim that there is no competition in the special access market made only generalized claims with little real support. For example, Ad Hoc insists that LECs "remain the sole source of special access connectivity at roughly 98% of business premises nationwide, even for the largest corporate users."[55] Ad Hoc

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[53] These parties include Time Warner Telecom, XO Communications, Sprint, AT&T, US LEC, Broadwing Communications and T-Mobile.

[54] This information can, of course, be provided confidentially, so that there would be no competitive harm to any party that provides it.

[55] Ad Hoc Comments at 14; *see also* XO Comments at 11-12; T-Mobile Comments at 7-8; Sprint Comments at 6.

cites the ETI paper identified above as support for this statement, but does not elaborate as to how this figure was derived or what it really means. Further, a review of the ETI analysis reveals that it essentially utilizes guesswork to arrive at a grossly inflated market size in order to minimize artificially the CLEC market share.

The ETI analysis begins with what it labels the "conservative estimate" that there are "3-million commercial buildings nationwide."[56] However, ETI provides no information as to the basis of this "estimate." ETI then estimates, based on data from 2002, that CLECs serve 30,000 buildings nationwide by way of traditional wireline facilities.[57] The error in ETI's approach is twofold: (1) a failure to consider all special access services, and (2) a failure to properly define the size of the market for the services that are considered.

As to the first error, by stating that CLECs can provide special access services to only 2% of businesses, ETI gives the impression that CLECs can compete for only 2% of the special access market, which is incorrect. Special access services include the local channel from the customer premises to the LEC end office ("tail circuit"), interoffice facilities ("IOF"), and the local channel from the LEC serving wire center to the carrier's point of presence ("entrance facilities"). The total market for special access services includes all these services. At most, ETI's analysis applies only to the first of these three services, while it ignores the substantial facilities-based competition that exists to provide the IOF and entrance facilities. Given the fact that ETI ignores all special access services except the tail circuits, its approach cannot yield a valid conclusion about the total special access market.

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56 Ad Hoc Comments, attached ETI paper at 16.

57 *Id.* at 19.

Second, even as an assessment of only one portion of the market, ETI still grossly understates the CLECs' share of the sub-market for tail circuits. The RHK market share analysis attached to BellSouth's Comments determined that alternate access vendors provide between 17% (based on revenue) and 46% (based on total capacity of the sub-market) of tail circuits.[58] This, of course, raises the question of how ETI can possibly claim that alternate vendors serve only 2% of the market. The answer lies in the fact that ETI assumes not only that there are 3 million business locations in the nation, but also that every single one is a candidate for special access service. Both assumptions are wrong.

Clearly, not every business in the entire country is a candidate for special access service. Although every business that utilizes more than a single carrier to meet its telecommunications needs requires some sort of access service, switched access service is indicated in all but a small percentage of cases. Most of the businesses in the country are not large enough to make it economical to have dedicated (special) access services. The fallacy of ETI's assumption to the contrary can be demonstrated in two ways.

First, again, ETI provides no clue as to how it arrives at the "estimate" that there are 3 million commercial buildings in the United States. At the same time, a 1999 study by the Energy Information Administration identified 4.657 million commercial buildings nationwide.[59] However, most of these buildings fall into categories such as "food service," "religious worship," "warehouse and storage," and "vacant." Clearly, none of these are likely consumers of special

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[58] Declaration of Stephanie Boyles, Attachment 6 to BellSouth Comments, at 2 ("Boyles Decl.").

[59] 1999 Commercial Buildings Energy Consumption Survey, Detailed Tables, Table B1 at 1, *available at* http://www.eia.doe.gov/emeu/cbecs/pdf/allbc.pdf.

access service. The study did identify 739,000 of the commercial establishments as office buildings, but gave no indication of such factors as whether these office buildings are multi-tenant or the size of the buildings. Thus, it cannot be determined with precision from this study how many business locations might be candidates for special access service, but it is certainly a small percentage of the 3 million assumed by ETI.

Second, BellSouth undertook to make a more realistic assessment of the actual number of business customers that might have sufficient traffic to require special access rather than switched access. For the purpose of this analysis, BellSouth began with the general assumption that business customers that spend modest amounts on all telecommunications services are unlikely candidates for special access service.[60] With this in mind, BellSouth utilized a database purchased from TNS Telecom to ascertain the amount that BellSouth's business customers spend on a monthly basis.[61] Business customers' monthly spend amounts were then categorized in one thousand dollar increments (e.g., 0-1,000, 1,001-2,000). The results of this analysis are shown in Attachment 3.

As depicted on Attachment 3, TNS Telecom estimates that BellSouth currently serves 1,821,948 business customers, which are located at 1,283,111 business locations. Of the total

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[60] For the purpose of this analysis, total telecommunications spend is defined as the firm's total monthly wireline communications bill, including voice, data and all other applications. Cable, ISP and telecom components are included, but wireless is not included.

[61] To develop this information, TNS conducts random samples of businesses across the nation to determine how much they spend each year. Using a model that it developed, TNS uses its samples to estimate the telecommunications spending characteristics of businesses based on size, location, industry, and other factors. TNS verifies its estimates by conducting 3,500 additional surveys each quarter. The analysis based on this information, however, was performed entirely by BellSouth. Accordingly, TNS does not warrant the accuracy of the calculations performed by BellSouth.

number of customers, 89.78% (1,635,799) spend less than one thousand dollars per month on all telecommunications services. Another 6.16% (112,296) spend between one thousand and two thousand dollars per month. Thus, if we assume that a customer spending less than two thousand dollars per month is unlikely to require special access, then only about 4% of BellSouth's business customers (i.e., 73,853) would even potentially be in the market for special access services.

As to business locations, on average, each of the 1,283,111 business locations has 1.42 business customers (1,821,948 customers ÷ 1,283,111 locations). Still, 85.6% of these locations (1,098,314) produce less than one thousand dollars in total telecommunications spend each month. Another 7.7% of these locations (98,486) produce between one thousand and two thousand dollars of total monthly spend. Thus, only about 6.7% of the business locations (86,311) in BellSouth's region have total expenditures attributable to all its customers that are sufficient to make provision of dedicated facilities to that building economically rational.

Obviously, the above analysis does not yield a precise number of customers who do (or even might) purchase access services, in part, because it does not take into account the many customers that are already purchasing competitive services from CLECs. Still, using BellSouth's base of business customers to produce a representative example of demand for telecommunications services does provide information about demand that should apply equally to all carriers. Thus, applying 6.7% to the 4.657 million total commercial buildings noted in the Energy Information Administration would yield a potential national market of approximately 312,000 business locations, which is certainly a much more realistic assessment of the potential

national market for special access services than the overblown number plucked from thin air by ETI.[62]

C. CLECs Control A Substantial Share Of The Fiber Facilities Currently In Place

BellSouth also undertook to develop a realistic assessment of the competitive facilities that exist in BellSouth's service area. To accomplish this, BellSouth commissioned 10th Street Advisors to perform an analysis of the number of buildings in BellSouth's service area to which fiber facilities are connected (i.e., "lit buildings") and to identify the providers of these facilities.[63] The methodology by which 10th Street performed this study is explained at length in the Reply Declaration of Dr. Stephanie Boyles (Attachment 2). For purposes of this analysis, the term "lit buildings" refers to buildings that are not ILEC central office buildings, which have fiber-enabled equipment located therein and a Common Language Location Identifier ("CLLI") code assigned to the equipment. In other words, the study focused on buildings to which high capacity, fiber-based services are being provided. Buildings were categorized as having fiber provided by BellSouth only, by CLECs only,[64] and by both BellSouth and CLECs.

For the purpose of the analysis, the MSAs were divided into four categories: Tier I, which includes the two largest MSAs in BellSouth's region (the only two among the 20 largest MSAs in the country), Atlanta and Miami-Ft. Lauderdale; Tier II, which includes the 8 next

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62 Moreover, at least one CLEC has publicly stated that it considers its target market to be enterprise customers that comprise 2% of the total business market. *See* footnote 92, *infra.*

63 As in the ETI estimate, the 10th Street analysis of "connected buildings" necessarily applies only to special access tail circuits or comparable facilities connected to the customers' premises.

64 The term CLEC is used herein generically to refer to all providers of fiber facilities connected to customer premises.

largest MSAs in BellSouth's region; Tier III, which includes the next 10 MSAs; and Tier IV, which includes all remaining areas. In general, the results of this study reflect the following:

1) CLECs have a substantial presence throughout BellSouth's territory, and provide fiber facilities to a large number of buildings that are not connected to BellSouth fiber;

2) CLECs serve a larger percentage of the total lit buildings in Tier II, Tier III, and Tier IV markets than in Tier I markets;

3) The CLECs that control the most competitive fiber have almost uniformly added fiber facilities in the last year;

4) A number of CLECs other than MCI and AT&T are providing substantial amounts of fiber in the various MSAs.

The 10th Street analysis identified 6,723 buildings connected to fiber in BellSouth's region, which collectively have 22,117 separate pieces of equipment served by the fiber.[65] Not surprisingly, more fiber facilities are in the larger markets than in smaller markets. For example, 28% of the total buildings served are in the two MSAs that compose Tier I; 33% are in Tier II; 16% in Tier III, and 23% in Tier IV.[66] However, the results of the 10th Street analysis rebut the contentions of the parties that claim in their Comments that there is no competition in areas other than the most densely populated.[67]

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[65] The 10th Street analysis focuses primarily on the number of lit buildings in BellSouth's region, which is distinguishable from the number of customers served. Again, the 10th Street study identified 6,723 buildings to which fiber is provided, and 22,117 individual pieces of equipment to which a CLLI coded is assigned. In other words, there are an average of 3.3 pieces of equipment per building. Thus, the number of customers is somewhere between 6,723 and 22,117. The precise number of customers cannot be determined because it is likely that some customers utilize more than one piece of equipment.

[66] Attachment 2, Exhibit A at 3.

[67] *See e.g.,* Broadwing/SAVVIS Comments at 16; Time Warner Telecom ("TWTC") Comments at 12; Nextel Comments at 10-12.

No doubt there are isolated pockets in BellSouth's service area in which there are no competitive fiber facilities, but there are also areas where there are no business customers and, in rare cases, no residents (*e.g.*, the Florida Everglades provides one such example). Thus, a lack of competitive facilities in a given area does not mean that BellSouth has a monopoly on the provision of special access service in the area; it may simply mean that there is no demand in the area for special access service to be provided by BellSouth or by any other carrier. However, in rural areas where demand exists, CLECs have met the demand by providing competitive services. The results of the 10th Street study confirm this competitive reality.

The chart below provides the number of facilities in each of the four market categories and the percentage of the buildings in each that have fiber provided by BellSouth only, by CLECs only and by both BellSouth and CLECs.

Tier	I	II	III	IV
CLEC ONLY	13.3%	32.7%	18.8%	24.4%
BST & CLEC	14.6%	19.9%	16.2%	11.4%
BST ONLY	72.1%	47.4%	65.0%	64.2%
# of Lit Buildings	1879	2227	1070	1547[68]

Combining the totals of the "CLEC only" and "BST and CLEC" categories, provides the total percentage of buildings to which CLECs provide facilities in each market category:

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[68] Attachment 2, Exhibit A at 3.

Tier I - 28%

Tier II - 53.0%

Tier III - 35%

Tier IV - 36%[69]

Thus, even in the least densely populated, Tier IV areas, CLECs still provide fiber facilities to 36% of the business locations that have fiber-based service. Further, CLECs are connected to a larger percentage of the buildings in the Tier II, III and IV markets than in the Tier I markets. Also, there is a greater percentage of "CLEC only" buildings in Tiers II, III and IV than in the two Tier I MSAs in BellSouth's region.

This analysis makes clear that CLECs build facilities to serve customers wherever there is demand for special access services. It is also clear that no carrier has a dominant position in any size market. Both BellSouth and CLECs have fiber facilities in geographic markets of all sizes, and frequently there are competing fiber facilities that connect to a given building.

Moreover, the CLECs are adding fiber facilities at a rapid rate, and the increase in the deployment of these facilities is virtually uniform among competitive carriers in BellSouth's region. Page 5 of Attachment 2 lists the 12 carriers in BellSouth's region that provide the most fiber. Of these 12 carriers, 10 increased the number of buildings to which they provide fiber during the 12-month period from April 2004 to April 2005.

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[69] *Id.* These percentages have been rounded to the nearest whole number.

Likewise, of the 19 next largest CLEC providers of fiber, 17 increased the number of buildings to which they provide fiber facilities during this 12-month period.[70]

The 10th Street study also makes clear that fiber networks are being deployed by a variety of different carriers in different areas. This is noteworthy because a number of parties argued, in the context of addressing the pending AT&T/SBC and MCI/Verizon mergers, that AT&T and MCI are the only providers of a substantial amount of competitive facilities.[71] This contention is disproven by the deployment of facilities documented by 10th Street. 10th Street analyzed each of the 20 largest MSAs in BellSouth's service area (i.e., Tiers I, II and III combined) as well as areas in each of the nine states in BellSouth's region that are outside of these 20 MSAs to identify the carriers that provide fiber-based service in each area. The results are depicted on Attachment 2, Exhibit A, pages 7 and 8, which shows the percentage of the total fiber connections[72] that are provided, respectively, by BellSouth, by each of the 12 largest CLECs, and by the combination of all other (smaller) CLECs. The largest and second largest CLEC providers for each of the 20 MSAs are as follow:

	Largest	2nd Largest
Atlanta	MCI	Other CLECs
Augusta	Other CLECs	AT&T/LOAC (tie)

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70 Attachment 2 at 6.

71 *See, e.g.,* American Petroleum Institute ("API") Comments at 8-9; T-Mobile Comments at 11.

72 The charts on Attachment 2, Exhibit A, pages 7-8 reflect the total number of fiber connections. Thus, if a building has both BellSouth-provided fiber and fiber provided by a CLEC, then both of these connections are counted.

Baton Rouge	Adelphia[73]	Other CLECs
Birmingham	Xspedius	Other CLECs
Charleston	Other CLECs	AT&T
Charlotte	TWTC	Other CLECs
Chattanooga	AT&T	Other CLECs
Columbia	Adelphia	Xpedius
Greensboro	TWTC	Other CLECs
Greenville	Xspedius	AT&T
Jackson	Adelphia	Xspedius
Jacksonville	Adelphia	AT&T
Knoxville	MCI	AT&T
Louisville	Adelphia	Xspedius
Memphis	TWTC	XO
Miami/Ft. Lauderdale	FP&L	AT&T
Nashville	XO	Adelphia
New Orleans	Cox	Other CLECs
Orlando	TWTC	Other CLECs
Raleigh	TWTC	Other CLECs

[73] Carriers are identified herein as they are identified in the CLONES database. The carrier currently named Telcove is identified as Adelphia for this reason.

MCI is the largest alternative provider in only two of the 20 largest MSAs in BellSouth's region, and the second largest in none of these MSAs. AT&T is the largest alternative provider in only one of these MSAs, is the second largest provider in 5 MSAs, and is tied for second largest in 1 other. Time Warner provides the most fiber in 5 MSAs, and Adelphia is the leader in 5 MSAs. Also, the combination of smaller CLECs is the second largest provider in 9 MSAs. The results were similar in the less densely populated areas of each state. The combination of smaller CLECs served the most lit buildings in four of the nine state-specific areas outside of the 20 largest MSAs. Finally, 10th Street identified a total of 87 carriers other than BellSouth that provide fiber facilities in BellSouth's service area.[74] Thus, facilities-based competition is being provided in BellSouth's region by a variety of alternative providers, not just AT&T and MCI.

To summarize the results of the 10th Street study, three trends clearly exist. One, CLECs have a substantial percentage of the fiber facilities in place to customer's premise throughout BellSouth's territory. Two, in the last year, CLECs almost uniformly increased the number of buildings to which they provide fiber facilities in BellSouth's territory. Three, fiber facilities are being provided by a wide range of CLECs. Given these results, it is clear that CLECs are capable of competing with BellSouth to provide the "last mile" or tail circuits of special access services, and they are doing so in a rapidly increasing number of locations.

Further, the fiber facilities identified in the 10th Street study can be used to provide more than high-capacity services. The fiber deployed to any given location allows the CLEC the

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[74] Attachment 2, Exhibit A at 32.

ability to provide the retail customer a wide range of services of varying capacities, including DS1. In this regard, the Commission stated the following in the context of the *TRRO*:

> [T]he record indicates that carriers can sometimes economically serve lower-capacity customers (*e.g.*, customers at the DS1 capacity level) in multi-tenant buildings because the incremental costs of providing channelized capacity over higher-capacity fiber loops are minimal when one or more other customers in a building are already served by competitive fiber of sufficient capacity, or the likelihood of capturing customers at higher capacity justifies deployment of facilities that can be channelized to the DS1 level.[75]

In support of this statement, the Commission cited a number of sources, including the following, which was part of an *ex parte* submission by BellSouth:

> [T]he most significant costs of providing high capacity services utilizing the CLEC's own network are associated with collocation, construction of a fiber ring, and installation of the [laterals] to connect buildings to the fiber ring. However, once these costs have been incurred to offer service at a DS-3 or higher transmission level, the incremental expense of offering DS-1 service is minimal.[76]

Finally, it is important to remember that the CLEC facilities depicted in the 10th Street study are only a fraction of the total CLEC facilities in place in BellSouth's region. The 10th Street study is based upon the information that carriers report for inclusion in Telcordia's CLONES database. There are, however, a number of CLECs in BellSouth's region that own fiber facilities and that serve customers with these facilities, but which do not provide their information to the CLONES database. For example, BellSouth identified four CLECs that are

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75 Unbundled Access to Network Elements; Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers, WC Docket No. 04-313 & CC Docket No. 01-338, Order on Remand, 20 FCC Rcd 2533, 2618, ¶ 154 (2005) ("TRRO").

76 *Id.* at 2618-19, n.432, citing Letter from Bennett L. Ross, General Counsel, BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-313, CC Docket No. 01-338 at 1-2 (filed Dec. 8, 2004).

not included in the CLONES database, but which advertise the scope and availability of their competitive services on their websites.

First, NewEdge Networks states that its "diverse network . . . enables [it] to deliver Frame Relay, ATM, IP, Private Line, and business-class DSL services to just about anywhere in the country."[77] The website also states that NewEdge's "Dedicated Internet access services [include] T-1, DS-3, OC-3, OC-12, OC-14, and Ethernet in over 30 metropolitan markets nationwide."[78] The network map for NewEdge that also appears on its website shows that NewEdge provides service throughout BellSouth's region, and that it has hubs in Orlando, Florida and in Atlanta, Georgia. [79]

Second, SCANA Communications states on its website that it "offers a wide range of leading edge communications solutions in South Carolina, North Carolina and Georgia."[80] The website also contains the statements that "SCANA offers services to help shorten the last mile," and "SCANA's Special Access Services can provide customized high-bandwidth connections between key business locations."[81] SCANA also advertises the ability to provide service at both the DS1 and OC-N level.[82]

Third, Memphis Networx states on its website that it provides "a state-of-the-art architecture that delivers the utmost reliability, availability and flexibility in the metropolitan

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77 *See* Attachment 4 at 1.

78 *Id.*

79 *Id.*

80 *Id.* at 4.

81 *Id.* at 3.

82 *Id.*

Memphis and Shelby County area."[83] Memphis Networx also states that it "extends SONET Transport, Metro Ethernet, Collocation, Internet and Security services from any business to any other business on [its] Metro Access network component, resulting in rapid 'grow on demand' transport for voice, video, or data applications."[84]

Fourth, Dukenet states on its website that it provides "local and long haul connectivity" throughout the Southeast.[85] Dukenet also states that it provides services at the DS-1, DS-3, OC-3, OC-12, OC-48 and OC-192 levels.[86]

Again, none of these four facilities-based providers are among the 87 identified by 10th Street as providing service in BellSouth's region. Further, each of them provides "last mile connections" to businesses in one or more metropolitan areas. In other words, they are the type of providers of the "last mile" facilities that some parties claim do not exist.

It is important to remember that the discussion above relates to the facilities in place that are presently being used to serve customers. There are also many other customers that can be served with these facilities, who are located both in the buildings that are currently connected and in surrounding buildings that can be readily connected. For example, in the *TRRO*, the Commission noted the statements of numerous carriers in their filings that, assuming sufficient

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83 *Id.* at 5.

84 *Id.*

85 *Id.* at 6.

86 *Id.* at 7. Interestingly, Dukenet also states, with considerably more candor than some of the parties that filed Comments in this proceeding, that it offers "term and volume discounts." *Id.*

traffic, they would connect a building to their fiber that was placed within 350 to 500 feet of the building.[87]

At least one CLEC presented to its investors a considerably more positive assessment of the ability to reach customers in the vicinity of its fiber. In a Time Warner Telecom ("TWTC") Investor Presentation, dated June 2005 (Attachment 5), TWTC noted that it currently provides service to 44 markets by using facilities that include "nearly 20,000 fiber route miles."[88] TWTC further stated that its ability to manage "direct connections to the customer" is based on the combination of a "powerful fiber network" and "extensive local infrastructure."[89] TWTC also has "robust optical, data and IP networks, combined with extensive local connectivity into buildings," as well as a "large and growing Enterprise customer base with significant market opportunity."[90]

TWTC also identified in its presentation the significant enterprise market opportunities that exist. Specifically, 70,000 "business sites reside in TWTC markets," and "over 50,000 business sites reside [within] one mile of [TWTC] fiber."[91] TWTC then provided to its investors a breakdown of the distance that these 50,000 "addressable enterprise businesses"[92] are from existing TWTC fiber.

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87 *TRRO*, 20 FCC Rcd at 2618, n.431.

88 Attachment 5, TWTC Presentation, at 7.

89 *Id.*

90 *Id.* at 5.

91 *Id.* at 6.

92 TWTC states that its estimation of addressable businesses is based on the likely spend on TWTC products by businesses with 100 or more employees located within one mile of TWTC fiber. Also, TWTC defines the enterprise market as mid and large size businesses with 100+ employees, and states that this definition applies to 2% of U.S. businesses. *Id.* at 6.

Distance from TWTC Fiber	Percentage of Businesses	Number of Businesses
0-300 ft.	43%	[21,500]
301-1,000 ft.	22%	[11,000]
1,001-2500 ft.	18%	[9,000]
2501-5280 ft.	17%	[8,500][93]

Thus, TWTC considers itself capable of serving any customer that it wishes to serve (based on potential telecommunications spend) that is within a mile of its facilities. TWTC also believes that it is within one mile of 71.4% of these targeted customers.[94] While TWTC covers only 44 markets nationwide, the combination of the 87 competitive carriers identified by 10th Street serve every city of significant size in BellSouth's territory. If we assume that they are as capable as TWTC of serving customers that they target within one mile of their facilities, then CLECs likely have the current capability to reach by extensions to their existing facilities almost every potential special access customer in BellSouth's nine-state region.

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93 The "Distance from TWTC Fiber" and "Percentage of Businesses" columns depict information that appears on page 6 of the TWTC presentation. The "Number of Businesses" column contains information that does not appear in the presentation. The numbers in this column were derived by BellSouth by multiplying 50,000 by the percentages provided by TWTC.

94 50,000 is 71.4% of 70,000.

V. SPECIAL ACCESS SERVICE IS SUBJECT TO SIGNIFICANT INTERMODAL COMPETITION

A number of parties claimed in their Comments that there is little or no intermodal competition in the market for special access services. This claim is based on the contentions that cable companies target residential customers and that they are generally not capable of providing business services.[95] These contentions are flatly wrong.

This claim was previously made by Ad Hoc and others in response to BellSouth's Petition for Forbearance from the Application of *Computer Inquiry* and Title II Common Carriage Requirements.[96] BellSouth noted in its Reply Comments in that proceeding that a similar argument had been made by AT&T in an earlier proceeding and had been rejected by the Commission. As noted in the Reply Comments, "[i]n the *Broadband Section 271 Forbearance Order*, the Commission 'reject[ed] AT&T's argument' that 'forbearance should not be granted because the cable providers tend not to serve business customers.'"[97] The Commission ruled that "'[b]ecause competitive LECs can still obtain access to network elements under Section 251

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95 Nextel Comments at 11; Ad Hoc Comments at 8.

96 Petition of BellSouth Telecommunications, Inc. For Forbearance Under 47 U.S.C. 160 (c) From Application of Computer Inquiry and Title II Common Carriage Requirements, WC Docket No. 04-405.

97 BellSouth Reply Comments, WC Docket No. 04-405, at 23, citing Petition for Forbearance of the Verizon Telephone Companies Pursuant to 47 U.S.C. § 160(c); SBC Communications Inc.'s Petition for Forbearance Under 47 U.S.C. § 160(c); Qwest Communications International Inc. Petition for Forbearance Under 47 U.S.C. § 160(c); BellSouth Telecommunications, Inc., Petition for Forbearance Under 47 U.S.C. § 160(c), WC Docket Nos. 01-338, 03-235, 03-260 & 04-48, Memorandum Opinion and Order, 19 FCC Rcd 21496, 21506, ¶ 22 & n.69 (2004) ("Broadband Section 271 Forbearance Order").

to serve business customers, and because of actual and potential intermodal competition from other services, . . . forbearance . . . is warranted' as to business customers."[98]

BellSouth also provided in its Reply Comments in that proceeding abundant information to demonstrate the presence of cable-based competition for the provision of business services.[99] To give one example, MCI announced in January of this year "that it will use the *cable* infrastructure of major companies such as Cox, Charter, and Time Warner to provide broadband services to business customers, and that, as a result of its access to cable, DSL, wireless and satellite broadband platforms, it can now offer broadband to 90 percent of U.S. business locations."[100]

Cable companies are well aware of the potential to market their services to the business community. As an attachment to an ex *parte* letter filed in the above-referenced docket on May 3, 2005, BellSouth provided the Commission with a compilation of advertisements by cable providers that specifically target business customers. A copy of this compilation is attached hereto as Attachment 6. This compilation includes advertising by Time Warner, Comcast, Charter, and Cox. With the exception of Comcast, all of these advertisements specifically target customers in BellSouth's service area.

Further, cable companies have been successful in their efforts to obtain business customers. BellSouth stated in the ex *parte* letter the following:

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98 *Id.*

99 *See id.* at 23-25.

100 *Id.* at 3, quoting MCI Press Release, *MCI Adds Cable to Internet Broadband Mix* (Jan. 11, 2005) ("MCI January 11 Press Release"), at http://global.mci.com/news/news2.xml?Newsid=13211.

> In first quarter 2005, over 27,000 small business customers disconnected their BellSouth® FastAccess® service, representing a 3.6% monthly churn rate (or, a 43% annual churn rate). Nearly half of these disconnecting customers that maintained Internet service left BellSouth in favor of competing broadband services offered by some other provider, with a significant proportion going to cable companies. Indeed, BellSouth research reveals that during the one-year period from 1Q04 to 1Q05, 29% of disconnecting small business FastAccess customers with 1-9 employees left for a cable modem alternative, while 31% of those with 10 or more employees left for a cable modem alternative.[101]

Thus, the evidence conclusively demonstrates that cable providers recognize the potential that exists in the business market, and they are making competitive inroads into this market. Cable providers directly compete against BellSouth to provide a wide range of services to business customers, including special access services, and in many cases, are doing so successfully. Once again, those parties that urge the imposition of restrictive price controls do so while choosing to ignore the facts.

VI. THE PENDENCY OF THE VERIZON/MCI AND SBC/AT&T MERGERS SHOULD NOT INFLUENCE THE COMMISSION'S DECISION IN THIS PROCEEDING

Most of the parties that favor rigid restraints on the LECs' pricing of special access services claim that the currently available competitive alternatives (which they characterize as few) are almost entirely attributable to AT&T and MCI. Thus, they argue, if the SBC/AT&T and Verizon/MCI mergers are completed, then there will be even less competition.[102]

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101 Letter from L. Barbee Ponder IV, Senior Regulatory Counsel-D.C., BellSouth, to Marlene H. Dortch, Secretary, FCC, WC Docket No. 04-405, at 3 (filed May 3, 2005). BellSouth's research contains a +/- 3.7% margin of error for customers with 1-9 employees and a +/- 5.9% margin of error for customers with 10 or more employees.

102 API Comments at 2-3; 8-9; TWTC Comments at 10-12, 19-20; Broadwing/SAVVIS Comments at 19-22.

At the outset, it is important to note that these arguments are based entirely upon conjecture. It is one thing to request, as Qwest does, that the Commission delay further action in this proceeding until the mergers are complete.[103] BellSouth does not support Qwest's approach because the record before the Commission establishes the immediate need for the removal of special access pricing restraints. Nevertheless, Qwest's approach at least would involve waiting to see whether the mergers affect the market for special access service before acting. In contrast, other parties predict what will occur if the mergers are completed, then ask the Commission to impose restrictive and unwarranted price controls on the basis of nothing more than their dire predictions. Obviously, the Commission cannot make critical policy decisions of the sort involved in this proceeding based on what might occur if the mergers are finalized.

Moreover, there is no consistency in the conjecture as to what will occur after the mergers. On the one hand, many parties predict that after the mergers, AT&T and MCI will cease to provide competitive alternatives to LEC special access service, and they contend that, for this reason, the need for the Commission to control LEC special access prices will increase. However, CompTel argues that after the mergers, "AT&T and MCI 'special access' price points will become BOC rates and, under Section 202, SBC and Verizon must make those rates available to similarly situated carriers."[104] Thus, in CompTel's view, Section 202 will control the rates that may be charged after the mergers.

Further, many of the parties that engaged in speculation as to future events made the mistake of discussing the effect of the mergers on competition to "the LECs' special access

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103 Qwest Comments at 1-3.

104 CompTel Comments at 28.

services" as if the LECs are a homogenous group in which each will be identically affected by the mergers.[105] To the contrary, each of the four LECs is in a unique position, and each would be affected differently by the mergers. This is important to remember because none of the parties' conjecture as to how the mergers would affect the special access market make predictions that relate to BellSouth in any way.

BellSouth already faces competition in its region from the other LECs. In the Comments of Verizon, it provided information about its efforts to compete outside of its region, and SBC at least implied in its Comments that it has similar intentions.[106] Given this, there are only two possible scenarios as to how the mergers would affect BellSouth. The first scenario is that the current level of competition from SBC and Verizon in BellSouth's region would remain the same. The second and more likely scenario is that the efforts of SBC and Verizon to compete in BellSouth's service area would increase. Since AT&T and MCI already have significant facilities in place throughout BellSouth's territory, it only makes sense that in a post-merger environment, SBC and Verizon would make use of these facilities to attempt to sell an integrated bundle of services to customers throughout BellSouth's nine-state region. In other words, they would become even more powerful competitors of BellSouth than they are now. Accordingly, if the Commission is inclined to consider the possible effect of the mergers on the special access market, then it should be aware that if the mergers have any effect in BellSouth's region, that effect will be to increase competition.

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105 *See generally*, BT America Comments at 7-10; Broadwing/SAVVIS Comments at 19-21.

106 Verizon Comments at 32-33; SBC Comments at 8.

VII. THERE IS NO NEED TO PLACE RESTRICTIONS ON THE LECS' USE OF TARIFF TERMS AND CONDITIONS

BellSouth stated in its Comments the belief that tariff elements such as volume and term discounts are standard in the telecommunications industry. BellSouth also noted that, for this reason, non-LEC parties have historically not argued that discounts, termination liability or other standard tariff/contract features should be prohibited across-the-board, but only that incumbent LECs should be prevented from using them.[107] The Comments filed in this proceeding were entirely consistent with this historical but illogical approach. Not a single non-LEC party contended that the Commission should issue a blanket ban against volume discounts, termination liability, or long term contracts, and not a single party claimed they did not enter into contracts with these same features. Instead, they claimed only that the incumbent LECs should not be allowed to have tariffs or contracts with these features.

BellSouth also noted in its Comments that the rationale for imposing tariff or contract restrictions on only the ILECs is predicated on the assumption of LEC market dominance.[108] Consistent with this approach, the parties that argue for tariff and/or contract restrictions to be imposed on ILECs do so based upon a two-step theory: (1) ILECs have such control of the market that they can be fairly said to possess market power; (2) ILECs utilize contract terms, discounts, or termination liability to maintain this market power by hindering competition. For example, ATX Communications Services, Inc., *et al.* ("ATX") complained about SBC's terms and conditions and argued that "[i]f SBC ever faced . . . competition, it would be compelled to

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107 BellSouth Comments at 57-58.

108 *Id.* at 58.

improve service, lower prices, or offer new products to expand its business. Instead, SBC exploits its market power to impair competitive entry and maintain its monopoly status."[109] Also, CompTel/ALTS claimed that purchasers of special access services are forced to purchase services under ILEC discount plans because this is the only alternative to purchasing the higher priced access services available on a month-to-month basis. This argument obviously assumes that there are no competitive providers of special access services, and that the ILEC service, therefore, is the only choice. All variations of this argument, however, suffer from a basic infirmity: they are wholly dependent on the claim that there is minimal or no competition and that the ILECs have market power. This argument must fail based on the evidence outlined above, particularly when these parties have failed to produce factual support for their contention that there is no competition.

The requests for restrictions on LECs' tariffed offerings should also fail for the additional reason that there is simply no need for these restrictions. CompTel/ALTS asserts that the Commission has the "authority to redress the anticompetitive effects of BOC tariffs in the context of a general rulemaking."[110] However, CompTel/ALTS' Comments provide a perfect illustration of why there is no need for this approach. CompTel/ALTS cites BellSouth's TSP discount plan as an example of the type of LEC discounts that should be addressed generally and prohibited.[111] However, as CompTel/ALTS acknowledges, questions concerning this plan were raised in a Complaint filed by AT&T and resolved by the Commission on the facts of that case.

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109 ATX Comments at 38.

110 CompTel/ALTS Comments at 34.

111 *Id.* at 33.

The Commission found that BellSouth's TSP discount favored BellSouth Long Distance over larger carriers, such as AT&T, and thereby violated the non-discrimination requirements of 272.[112] Thus, the Commission addressed AT&T's complaint under the procedures in the Commission's rules that are available for this purpose.

If the Commission were to create a general rule barring certain types of discounts (assuming there was a substantive basis to do so, which there is not), the enforcement of this rule would involve going through precisely the same sort of complaint process that was required to resolve the AT&T Complaint. Thus, there would be no benefit to creating an additional rule to supplement those that already exist. If any of the parties that argue for tariff and contract restrictions have at some future point a basis to argue that an ILEC has violated §§ 272, 201, 202, or any of the other rules that apply to the pertinent product offerings, then it is free to file a complaint. However, there is no need to expand the rules to create additional restrictions. Moreover, there is no basis to do so. The creation of rules containing generic tariff restrictions requires a greater foundation than unproven claims of ILEC market power and unsupported arguments that presume future ILEC abuses based on the use of this non-existent market power.

VIII. THE PROPOSALS FOR RESTRICTIVE PRICE CONTROLS MUST BE REJECTED

The parties that advocate restrictive controls on the price of special access services recommend a variety of approaches. Most argue that pricing flexibility should be revoked; some

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[112] AT&T Corp., Complainant, v. BellSouth Telecommunications, Inc., Defendant, File No. EB-04-MD-010, Memorandum Opinion and Order, 19 FCC Rcd 23898, 23903-06, ¶¶ 18-22 (2004).

advocate that prices be annually reduced by a productivity factor; some advocate that prices be benchmarked to the prices of competitors; and some argue for benchmarking rates to an 11.25% rate of return. These various proposals all have two things in common: 1) they seek to reduce the rates for special access services to artificially low levels, and 2) they have no substantive support. In short, the parties that advocate restrictive price controls seek low special access rates by any means, under any rationale, and without any support. These proposals are especially troubling because they would require the Commission to embark on a radical departure from its current policies.

The Commission recently published a draft of its revised strategic plan for 2006-2011, which listed (in part) the following as the first of its two principal objectives:

> **Objective 1: The Commission shall foster sustainable competition across the entire communications sector.**
>
> The Commission shall implement and enforce policies that ensure that U.S. consumers benefit from competition in domestic and global services. Domestically, the Commission shall implement rules and policies that promote open and competitive entry by communications service providers and place primary reliance on market forces to stimulate competition, technical innovation, and development of new services for the benefit of consumers. The Commission shall seek to establish a consistent and transparent regulatory framework across all communications platforms (*e.g.*, wireline, wireless, satellite, cable) to encourage both intra-modal and inter-modal competition.[113]

Further, the Commission noted the following as factors that affect the achievement of its goals:

> *Technological*: New technologies are challenging existing regulatory structures domestically and internationally, while enabling consumers to have access to more services than ever before. For example, traditional providers of one type of service are increasingly entering new markets by offering voice, video, and

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[113] FCC Draft Strategic Plan for 2006-2011, at 9, *available at* http://www.fcc.gov/omd/strategicplan/.

broadband data services that have the potential to compete with incumbent providers of such services.

. . .

Organizational: The Commission must conduct effective policy analysis and innovative rulemakings, adopt sound economic decision-making based on access to current and relevant data in developing competition policies and rules, and take enforcement action when necessary.[114]

Thus, the parties proposing a restrictive form of price regulation advocate action that is diametrically opposed to the Commission's current policies and direction. Given this, the Commission should only consider these proposals if there were compelling evidence that conclusively established that the requested regulation was necessary. However, there is no substantive support for any of the proposals to lower access services prices by any means. In fact, after reviewing each of the proposals, Drs. Furchtgott-Roth and Hausman provided the following assessment:

> Several comments suggest a need for expanded price regulation of special access services. These comments lack:
>
> - Any comprehensive statement of the economic basis for the proper form of price regulation;
> - Any economic basis to continue or to modify current price regulation;
> - Any detailed, verifiable description of competitive conditions in any market, much less all markets;
> - Any explanation of how proposed new forms of regulation would result in the "right" economic price instead of an arbitrary price without economic foundation; and
> - Any consideration that setting the wrong prices through regulation can do substantial harm to competitive conditions in markets.[115]

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114 *Id.* at 10.

115 Furchtgott-Roth/Hausman Reply Decl. at 3.

Drs. Furchtgott-Roth and Hausman also confirmed their initial conclusion that it would be exceedingly difficult, if not impossible, for the Commission to set a "correct" price for special access services, and in the current competitive environment, there is no need to attempt to do so. As they stated, "[p]rice regulation cannot possibly be effective unless certain conditions are met. We find that special access services do not meet any, much less all, of the standard characteristics that economists would use to demonstrate a rational basis for price regulation. Indeed, distortions on investment and other harms are likely to outweigh any conceivable benefits from price regulation."[116]

Drs. Furchtgott-Roth and Hausman also noted that there is substantial competition throughout BellSouth's territory, and "[e]ven in those areas with limited competition, the unprofitability of losing even a few customers in a large fixed cost, relatively small incremental cost market such as special access services means that ILECs have little incentive to raise prices."[117] They also reiterated that "special access services do not lend themselves easily to price regulation, even price cap regulation. Services with heterogeneous technologies that are constantly changing and with geographic networks that are also constantly changing cannot rationally be regulated."[118] Finally, the Furchtgott-Roth/Hausman Reply Declaration states that the very nature of the questions raised in the *NPRM* illustrates the difficulty of attempting to

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116 *Id.* at 2.

117 *Id.*

118 *Id.*

apply price regulation to special access services. Specifically, "[n]ew forms of price regulation along the lines implied in the . . . *NPRM* make little sense under these conditions."[119]

Again, the essentially unsupported proposals to impose restrictive forms of price regulation fell into three general categories: 1) proposals that the Commission set prices by using existing competition as a benchmark; 2) proposals to utilize the equivalent of an 11.25% rate of return to benchmark prices; and 3) proposals to impose a productivity factor (or at least some factor that would be used to reduce prices). As noted above, none of these proposals are supported by the facts, by any plausible economic analysis, or by any conceivable policy goals. For these and other reasons explained below, these proposals should be rejected.

A. Using Competition As A Benchmark

In its Comments, CompTel/ALTS proposed that the Commission set LEC special access prices at the levels being charged by competitors that are currently providing special access services. In making the proposal, CompTel/ALTS differs from numerous parties in that it actually acknowledges the existence of competition to provide special access services and concedes the "inadequacy of rate-of-return and price cap regulation, particularly in a competitive environment."[120] Nevertheless, CompTel/ALTS still contends that the Commission must set special access prices, *albeit* by basing them on competitive prices in the market. This proposal must be rejected because it has at least five deficiencies, which were identified by Drs. Furchtgott-Roth and Hausman.

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119 *Id.* at 3.

120 *Id.* at 4, citing CompTel/ALTS Comments at 21-25.

One, the proposal is based on the premise that a competitor has successfully entered a market. However, "[i]f competitive facilities-based entry in a market is not only feasible but actually achieved—and thus at least one competitor is present—it is difficult to understand the economic basis for price regulation."[121]

Two, there is no basis to benchmark prices in one area to prices in other areas in which different market conditions prevail. "Differences in market conditions, particularly cost conditions, cannot necessarily be accurately captured by comparing rates in those markets where competitors have entered to rates in those markets without entry. Indeed, it would be reasonable to infer that cost conditions do differ significantly, which explains in part the differing competitive outcomes."[122]

Three, "special access services are heterogeneous, geographically-specific, technologically-evolving services offered jointly with other services on common facilities and facing rapidly changing demand."[123] For this reason, the mechanics of any scheme to regulate prices that involved benchmarking would be difficult to manage. In fact, past attempts by the Commission to apply benchmarking to rates for cable services proved unsuccessful and were ultimately abandoned.[124]

Four, a benchmarking scheme would create perverse incentives for CLECs. If ILEC rates were based directly on CLEC rates, then this regulatory scheme would necessarily

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121 *Id.* at 5.

122 *Id.* at 5-6.

123 *Id.* at 6.

124 *Id.* at 7.

influence the CLECs pricing behavior. Rather than setting its rates based on competition, the CLEC would make strategic decisions based on its ability to dictate ILEC pricing.[125]

Five, benchmarking has the potential to discourage both competitive entry and the construction of facilities by CLECs. If ILEC prices are set artificially low, this would make it extremely difficult for CLECs to compete on price and would discourage investment in CLEC owned facilities.[126]

B. Setting Prices To Achieve An 11.25% Rate Of Return

A number of parties advocated that the Commission reinitialize prices to yield the equivalent of an 11.25% rate of return.[127] No party, however, presented a substantive defense of this rate as the correct one in the current market. To give one example of the typical approach, Ad Hoc's Comments contain a lengthy discussion of why the Commission set the rate of return at 11.25% for a variety of interstate services in 1990.[128]

The problem with Ad Hocs' attempt to apply a 15-year old rate is that it ignores the fundamental changes that have occurred in the interim. As Drs. Furchtgott-Roth and Hausman noted, the 11.25% "rate of return was set in 1990, when local competition was usually unlawful, well before the Telecommunications Act of 1996. The Telecommunications Act of 1996 provides no 'regulatory guarantee' of earning a specific rate of return."[129] In other words, the

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125 *Id.* at 8.

126 *Id.*.

127 Ad Hoc Comments at 37; ATX Comments at 22-23; API Comments at 9-10; PAETEC Comments at 10.

128 Ad Hoc Comments at 38-43.

129 Furchtgott-Roth/Hausman Reply Decl. at 18.

regulatory framework that existed in 1990 was due, in part, to market conditions that were vastly different than they are today. There was no competition in the special access market in 1990, which made the provision of special access services considerably less risky. Even if it were possible for the Commission to set a correct price for special access service, it is certainly not possible to do so by basing the price on a historical rate of return that was set under vastly different circumstances.[130]

Moreover, the result of taking this approach would be to decrease investment, which would ultimately result in a decrease of available services. As Drs. Furchtgott-Roth and Hausman explained:

> [B]oth ILECs and CLECs [] have made, and continue to make, substantial investments in fiber in their networks to provide high capacity services such as DS1, DS3 and fiber-optic (OCn) based services. These investments are long-lived, fixed-cost investments with potentially high risk over a significant period of time given the continuing advance of competitive technologies. The future looks quite risky for these types of services both as alternative technologies become available and as cable companies expand their service offerings to businesses."[131]

Thus, the parties that urge the imposition of an 11.25% rate of return type benchmark are advocating that the Commission limit the potential upside to the investment, while the potential

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[130] Ad Hoc also attempted to justify the current use of an 11.25% return by arguing that states that have applied rate of return regulation in the last 15 years have set rates to produce lower returns. These states, however, did not set a rate of return for a single service, and neither did the Commission when it set the 11.25% rate of return in 1990. *Represcribing the Authorized Rate of Return for Interstate Services of Local Exchange Carriers*, CC Docket No. 89-624, *Order*, 5 FCC Rcd 7507, 7507, ¶ 1(1990). Rate-of-return regulation has always been applied firm-wide to set an overall rate of return that the firm would derive from the combination of high margin services, low margin services and services that have negative returns. There is no precedent for the approach advocated by Ad Hoc and others, i.e., capping the margin for a single service because it is perceived to be profitable, without applying the "rate-of-return" to all other services.

[131] Furchtgott-Roth/Hausman Reply Decl. at 18.

downside continues to fully apply. Obviously, under this approach, the economic incentives to invest will decrease.[132]

Moreover, this approach will also reduce competition. Again, the sole reason that many parties advocate an 11.25% rate-of-return type benchmark is to reduce prices. However, price reductions to artificially low levels will make it more difficult for CLECs to enter the market and for those now in the market to continue to compete. "The result will be less facilities-based competition."[133]

C. The Use Of A Productivity Factor To Reduce Rates

Although a number of parties suggest the use of a productivity or X-factor to reduce rates, not a single party produced a study to determine the correct rate. In fact, no party even provided a basis to believe that the conditions that were cited as support for the productivity factor in 1990 still prevail today. At the same time, Verizon submitted the Declaration of Dr. William E. Taylor in which he specifically rebutted this notion.[134]

Beyond the general difficulty of using a productivity factor for any service, there are specific problems that arise when attempting to do so for special access. As stated by Drs. Furchtgott-Roth and Hausman, "[t]he productivity offset for a service with rapidly changing technology cannot rationally be calculated with any reasonable degree of accuracy."[135] Beyond this, they also addressed the problems with using a productivity price factor established in 1990:

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132 *Id.* at 19.

133 *Id.*

134 Comments of Verizon, Attachment C, Taylor Declaration, ¶¶ 65-68.

135 Furchtgott-Roth/Hausman Reply Decl. at 2-3.

> Productivity conditions in the late 1980s (used to set the factor in 1990) and technological conditions have changed greatly over the intervening 15-20 years. No competitive industry would ever attempt to set its prices based on conditions of 20 years ago. Indeed, if a regulatory [body] based a required price change on conditions from 15-20 years ago in a technologically changing market, economists would view such regulated prices as having no rational economic foundation. Despite the enthusiasm for the *concept* of a productivity adjustment factor, no party submitted an updated productivity factor based on empirical analysis that has any relationship to the technology used in providing special access today . . . .[136]

Given this, "the Commission lacks the necessary information to re-impose a price cap with a relevant productivity factor, even if it were appropriate to do so (which is not the case)."[137]

Moreover, the dangers of imposing a productivity factor for the purpose of lowering prices are also substantial. As noted above, the use of an 11.25% benchmark to artificially lower prices presents the danger of both retarding investment and hindering competition. The use of a productivity factor to artificially lower prices will result in precisely the same damage to the market and to competition.

IX. CONCLUSION

It is clear that competition for special access services is substantial and increasing. Because the current level of competition is more than adequate to constrain prices, there is no need to place the restrictive pricing controls upon LECs that some parties advocate. The economic harm of doing so would far outweigh any possible benefit. For all these reasons, the

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136 *Id.* at 19-20.

137 *Id.* at 20.

Commission should immediately remove all restraints on the LECs' ability to price special access services.

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CERTIFICATE OF SERVICE

I do hereby certify that I have this 29th day of July 2005 served the following parties to this action with a copy of the foregoing **REPLY COMMENTS OF BELLSOUTH** by electronic filing and/or by placing a copy of the same in the United States Mail, addressed to the parties listed on the attached service list.

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